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ABSTRACT

An examination was made of the U.S. Department of Education grants awarded to the Cleveland School District for desegregation activities, including how Department of Education funds were used by the school district and how the department administered and monitored Magnet School grants awarded to the school district for fiscal years 1986 and 1987. Following an executive summary, this report has three chapters: (1) introduction; (2) amount and use of federal funds for desegregation activities; and (3) noncompliance with federal regulations for grant administration. The information indicates that the the district generally used the $30.2 million for purposes consistent with the desegregation court order. However, the district accumulated excessive federal cash balances, retained them for long periods, did not submit financial reports, and used a procurement system that did not satisfy documentation standards promulgated by the Department of Education. Appended are comments from the Department of Education and the Cleveland School District as well as five tables. (SI)

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United States General Accounting Office

GAO

Report to the Honorable
Louis Stokes, House of Representatives

August 1989

DESEGREGATION ACTIVITIES

Administration of Education Grant Funds at the Cleveland School District

EA 021 477

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-234418

August 29, 1989

The Honorable Louis Stokes
House of Representatives

Dear Mr. Stokes:

In response to your request, we reviewed the Department of Education grants awarded to the Cleveland School District for desegregation activities. This report is the result of information collected in our review, including how Education funds were used by the school district and how Education administered and monitored Magnet School grants awarded to the school district for fiscal years 1986 and 1987.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Secretary of Education, the Cleveland School District, and appropriate congressional committees and make copies available to others on request.

The major contributors to this report are listed in appendix III.

Sincerely yours,

Lawrence H. Thompson

Lawrence H. Thompson
Assistant Comptroller General

Executive Summary

Purpose

From 1978 through June 1987, the Department of Education awarded the Cleveland School District $30.2 million in desegregation grant funds under the Emergency School Aid Act (ESAA) and the Magnet School Assistance Program. Concerns about how these federal funds were used prompted Representative Louis Stokes to ask GAO to determine

- how much federal funding for desegregation activities the Cleveland School District had received,
- whether the school district spent the federal funds for activities specified in the 1978 court order and subsequent federal grant agreements, and
- whether the school district complied with the administrative conditions and restrictions for federal grants.

GAO also sought to determine whether Education adequately monitored and administered the grant agreements.

Background

In 1976, the U.S. District Court for Northern Ohio found that Cleveland schools discriminated against black students and were racially segregated. By February 1978, a desegregation plan had been developed that was adopted by the Court in the form of a court order. Since 1978, the school district's desegregation efforts have (1) been funded by state, local, and federal funds and (2) focused on achieving the goals established in the plan and maintaining those goals that have been achieved. From 1977 to 1982, the school district received $27.7 million in federal ESAA grants. From 1985 to 1987, $2.5 million in federal Magnet School grant funds were awarded to the district.

Results in Brief

GAO found that the total federal funding the school district had received from 1978 through 1987 was $385.9 million, funded as follows: federal government, $30.2 million (7.8 percent); state government, $130.2 million (33.7 percent); and local government, $225.5 million (58.5 percent). No federal funds were provided specifically for desegregation activities after June 1987 (see p. 15). Federal funds were appropriately spent on desegregation activities, but the school district did not comply with all the specifications in the 1978 court order and subsequent federal grant agreements. Use of both ESAA and Magnet School program funds was consistent with the court order. The school district did not, however, comply with the administrative conditions and restrictions for federal grants. The school district (1) requested and received excessive advances of federal grant funds; (2) accrued interest on these advances,

but did not report or remit this income to Education; (3) without the required Education approval, obligated and spent first-year grant funds in the second year; and (4) did not comply with some federal procurement requirements. In addition, in school year 1985-86, the school district used more than $1.5 million of ESAA 1979-80 and 1981-82 funds for the Magnet School and other Education grant programs.

The deficiencies GAO found in the school district went undetected because Education officials did not adequately monitor and administer the grant agreements, as prescribed by federal regulations and Office of Management and Budget circulars.

Principal Findings

Funds Used for Court-Ordered and Education-Approved Activities

The largest ESAA and Magnet School funding was for (1) staff development and student training in human relations ($5.4 million) and (2) magnet schools and vocational schools ($5.2 million). Because complete ESAA program records were unavailable, GAO could not determine whether ESAA activities complied with purposes approved by Education. GAO did determine that the school district used the $2.5 million in Magnet School grant funds for six activities approved by Education. Two of the activities were (1) starting additional magnet schools and (2) developing and testing redesigned curricula. GAO tests of grant expenditures, primarily to buy equipment and pay salaries, showed that these funds were used for Education-approved activities (see pp. 15-20).

Cleveland School District Did Not Comply With Regulations

The Cleveland School District violated federal regulations by not returning to Education $1,553,000 in unobligated cash advances from the ESAA grants for the 1979-80 and 1981-82 school years. Later, the school district used $825,000 of the total funds to cover the first 14 months of outlays under the Magnet School grant program (from Oct. 1985 through Nov. 1986). The remaining $728,000 was used for other Education grant programs. According to Department of Education records, no subsequent reductions were made to these other grants. Therefore, the Cleveland School District received $1,553,000 more than it should have.

In addition, the school district (1) improperly obligated and spent $1.4 million of first-year Magnet School grant funds during the second year,

without receiving written authorization from Education officials (see p. 24), and (2) did not have all required documentation for purchases of $10,000 or more to show the basis for contractor selection and the justification for the reasonableness of contract awards (see pp. 32-36).

The school district also requested and received advances for the second year of the Magnet School program that exceeded its cash needs. As of January 1989, the district retained $197,000 from these advances that, according to regulations, should have been returned to Education. GAO found that the district's reports to Education included evidence that the district's cash advances exceeded its needs. Education officials did not, however, follow up on such evidence and remained unaware of the problems. Education officials rely on the grant recipient, they told us, to return to Education any excess cash advances not expended at the end of a grant period and any interest income earned on these cash advances. After GAO informed Education officials of its findings, the officials notified the district that in accordance with federal regulations, the funds should be returned. Education, in commenting on a draft of this report, said that the Cleveland School District sent a $200,000 check for these excess funds (see pp. 24-26).

Education Did Not Properly Oversee Grant Funds

Education's fiscal year 1987 report on its Internal Controls Program indicated weaknesses in grants monitoring and administration, including closing out grants. Education officials told GAO that in fiscal year 1987, a backlog of 14,000 grant files, ostensibly closed out, had been sent to the Federal Records Center without reports and actions being completed, as required by federal regulations. The 1987 report on the Internal Controls Program included statements assuring corrective action; GAO's review indicated, however, that these weaknesses still exist (see pp. 30-31).

During the 1980s, Education annually awarded the school district grants totaling millions of dollars, but did not properly oversee the district's administration of those funds. From discussions with school district officials and documents obtained from them, GAO concluded that the district's policies and practices concerning the Magnet School grants applied to other 1978-88 Education grants it received. Therefore, similar weaknesses and shortcomings probably would be found in those grants. In addition, GAO's review indicates that the weaknesses found in Education's administration of Cleveland's grant programs are systemic (see pp. 36-37).

Recommendations

GAO recommends that the Secretary of Education direct the Cleveland School District to

- return the $1,553,000 of ESAA funds that remained in its accounts when the authorization for ESAA expired in 1982 and
- review its procurement system to ensure it complies with federal procurement regulations.

GAO also recommends that the Secretary of Education work with school district officials to determine the amounts of interest, earned on excessive cash advances from federal grant programs over the years, that should be returned. Finally, GAO recommends that the Office of the Inspector General in Education review Education's policies and practices for grants, especially relating to cash management and closing out grants. This review should determine whether Education's grant management weaknesses concerning grants for the Cleveland Magnet School Program are prevalent in other grant programs and school districts.

Agency Comments

In its comments on a draft of this report, the Department of Education agreed with GAO's recommendations to review the Cleveland School District's procurement system and to determine the amount of earned interest to be returned to Education. But it did not agree with GAO's recommendation that $1,553,000 of ESAA funds be returned to Education.

In its comments, the Department of Education stated that the Secretary is barred from recovering this $1,553,000 by 20 U.S.C. 1234a (k) because the violation—not returning the unspent ESAA funds to Education—occurred more than 5 years ago. GAO interprets this statute to mean that federal funds cannot be recovered from grantees 5 years after the grant funds have been expended. Therefore, GAO believes that its recommendation is valid because, although advanced to the Cleveland School District in fiscal years 1980 and 1982, the $1,553,000 in question was not expended until fiscal years 1986 and 1987.

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Abbreviations

ESAA	Emergency School Aid Act
FMFIA	Federal Managers' Financial Integrity Act
OIG	Office of the Inspector General (Education)
OMB	Office of Management and Budget

Introduction

In 1978, the U.S. District Court for Northern Ohio issued an order to desegregate the public schools operated by the Cleveland School District. Since then, the district has used federal, state, and local funds to support its desegregation efforts. Concerns about how the federal funds were used prompted Representative Louis Stokes, in June 1988, to ask us to review desegregation activities in the school district from 1978 through 1988.

The school district received federal funds for desegregation activities from 1978 until 1982 through Department of Education grants under the Emergency School Aid Act (ESAA). The ESAA grants were to (1) meet school districts' special needs in eliminating segregation and discrimination among students and faculty in elementary and secondary schools and (2) encourage school districts to voluntarily eliminate, reduce, or prevent minority group isolation in elementary and secondary schools with large proportions of minority group students. A variety of desegregation activities were funded, including school and community relations, staff development and student training, and magnet schools. (Magnet school is the term used for a school or education center that offers a special curriculum that can attract substantial numbers of students from different racial backgrounds. Such a curriculum complements and enhances a school district's overall desegregation plan).

In 1981, the ESAA program was consolidated with the Chapter 2 Block Grants Program. The Chapter 2 program awarded funds directly to the states, which were required to pass down 80 percent of their grants to local school districts. School districts, in turn, were given the flexibility to decide how to allocate their grants among the various eligible program activities, including desegregation. From 1982 through 1989, under the program, funds were awarded to the school district through the Ohio department of education. The school district may have used these funds for desegregation activities; it did not, however, compile data showing different allocations because the Department of Education had no such requirement.

Beginning in 1984, the Magnet School Assistance Program also provided federal funds for desegregation activities. These funds are to (1) help school districts establish and operate magnet schools and (2) encourage districts to develop courses of instruction for students who attend these schools. Such courses are to strengthen students' vocational skills and knowledge of academic subjects. The Cleveland School District received Magnet School funds in fiscal year 1985 (for school year 1985-86) and in fiscal year 1986 (for school year 1986-87).

Desegregation of Cleveland School District

In 1978, the U.S. District Court for Northern Ohio issued an order stemming from a 1976 opinion that found Cleveland schools discriminated against black students and were racially segregated. The opinion cited over 200 specific acts that caused or perpetuated racial segregation, including (1) constructing schools so as to prevent or reduce the likelihood of black and white students attending school together and (2) changing school boundaries, resulting in new segregation or intensifying existing segregation.

In September 1976, the Court appointed a desegregation expert to develop a comprehensive plan for the school system to correct the violations and identify the school district's administrative needs to ensure desegregation. The plan was adopted by the Court in the form of an order issued on February 6, 1978. The plan included 14 requirements, as follows:

1. Student assignments: The racial composition of each school is to reflect the school system as a whole.

2. Testing and tracking (ability grouping): Testing and tracking should not resegregate students.

3. Reading: Improved reading performance by all students is to be aggressively pursued; in addition, the gap between the reading scores of black and white students is to be closed.

4. Counseling and career guidance: Students are to be counseled in a racially unbiased manner.

5. Magnet schools and programs, as well as vocational schools and programs: Magnet and vocational schools and programs are to enhance and aid desegregation.

6. Cooperation with universities, businesses, and cultural institutions: The school system is to reach out to business, educational, and cultural organizations to expand educational opportunities and school quality.

7. Extracurricular activities: All students are to have equal access to extracurricular activities.

8. Staff development and student training in human relations: Staff and students are to receive training about desegregated education.

9. Student rights: Discipline is to be applied fairly to students.

10. School community relations: The school system is to improve relations with the community and parents.

11. Transportation: Students are to be transported to and from school safely, economically, and efficiently.

12. Safety and security: Schools are to be safe.

13. Management and finance: The system is to be well managed; this would require (1) administrative reorganization with emphasis on management systems and (2) decision-making decentralized at the school level.

14. Staff desegregation: The staff at each school is to be desegregated.

Since 1978, the Cleveland School District's desegregation efforts have been focused on achieving the goals established in this plan. At the time of our review (July 1988 to Feb. 1989), the district's desegregation efforts included completing unfinished tasks in the plan and maintaining the positive results achieved over the years.

Monitoring the Desegregation Process

In May 1978 the U.S. District Court ordered that the office on school monitoring and community relations (the monitoring office) be established to observe, assess, and report on the district's progress, as well as foster public awareness and understanding of the desegregation process. The monitoring office is to provide the Court a credible, independent source of reliable information on whether remedies are sufficient and are being implemented effectively. The office employs a professional staff with expertise in areas such as education, law, community relations, and principles of school desegregation. It regularly submits written reports to the U.S. District Court on various desegregation matters.

According to data compiled by the monitoring office in a 1988 report, the Cleveland School District had achieved some goals in the desegregation plan. With relatively few exceptions, the Cleveland schools had become racially representative of the district's total student enrollment. In general, progress was positive and continuing, with measurable achievements in reading scores, especially in the elementary grades, throughout the school district; similar progress in improved mathematics test scores since 1978-79 was evident in grades 3 through 8.

Other aspects of school district programs and activities showed mixed results in school year 1986-87. Magnet schools enrolled 7 percent of all students. For several magnet schools, however, enrollment rates were less than capacity; some were underenrolled by 30 percent. For grade 9 students, 45 percent were not promoted to grade 10; the second consecutive year the nonpromoted rate was over 40 percent. For all grades, 15 percent were not promoted. The dropout rate was 46 percent for the class of 1987, the fourth successive graduating class with a dropout rate exceeding 40 percent.

Objectives, Scope, and Methodology

In his request letter to us and in subsequent meetings, Congressman Stokes asked us to determine

- how much federal funding for desegregation activities the Cleveland School District had received,
- whether the school district spent the funds for activities specified in the 1978 desegregation court order and subsequent federal grant agreements, and
- whether the school district complied with federal grant administrative conditions and restrictions.

We also sought to determine whether Education adequately monitored and administered the grant agreements.

In response to the Congressman's request, we interviewed officials and examined available documentation at the Department of Education, the Cleveland School District, and the monitoring office. We limited most aspects of our audit to the Magnet School Assistance Program grant because (1) the federal retention period had lapsed for records of ESAA grants and Education had destroyed the records and (2) pertinent documents were not readily available in usable form at Education or the school district. Education's administrative regulations require both Education and grantees to retain financial records, supporting source documents, and other records pertinent to a grant for 3 years after the grantee submits its last expenditure report for a given period. By using a combination of budget data obtained from the school district and cost data included in reports issued by the monitoring office, however, we were able to develop enough general information to determine whether the school district's use of ESAA grant funds was consistent with desegregation court orders. We were unable to gather enough information to determine whether the school district's use of these funds complied with federal grant conditions and restrictions.

Our audit of the Magnet School Assistance Program grant included reviewing grant agreements, approved grant applications, budgets, program and financial reports submitted to the Department of Education by the Cleveland School District, official contract files, and various accounting records and reports. We interviewed Education officials responsible for grants management and financial management; officials in the Office of Management Improvement Services; as well as program officials in the Office of Elementary and Secondary Education, who are responsible for the Magnet School Assistance Program; we also obtained related documents. In addition, we interviewed Cleveland School District officials responsible for the technical-vocational education division, the accounting division, and the purchasing office.

To determine whether grant funds were used in accordance with Education-approved conditions and restrictions, we reviewed the expenditures charged against the grant in the school district's accounting system records. We also reviewed a sample of 14 equipment purchases made for the technical-vocational program. For this review, we obtained documentary information on the use of the equipment and visited one school for verification. At the monitoring office, we interviewed the director and obtained reports issued on subjects such as desegregation funding and the status of the desegregation effort.

We reviewed a January 1987 audit report on school district programs funded with federal assistance from January 1, 1985 through June 30, 1986. The report, prepared by a public accounting firm, included (1) tests of several Department of Education categorical program grants awarded to the school district (the tests did not include the magnet school grant) and (2) several findings and recommendations relating to grant administration policies and practices similar to those in our report. We also spoke with Education's Office of the Inspector General (OIG) about the follow-up and resolution of audit findings concerning Education programs, which were reported by public accounting firms.

We reviewed the reports for fiscal years 1987 and 1988 on the Internal Controls Program in Education; these reports are compiled annually through the Federal Managers' Financial Integrity Act (FMFIA). The fiscal year 1987 report included discussions of several internal control weaknesses relating to the same grants management activities that we were reviewing. To determine the basis for Education's report position that the identified internal control weaknesses had been corrected, we spoke with officials in Education's OIG and Office of Management Improvement Services.

We conducted our review from July 1988 to February 1989 in accordance with generally accepted government auditing standards.

Amount and Use of Federal Funds for Desegregation Activities

From the 1978 desegregation court order through June 1987, the Cleveland School District received federal desegregation grant funds of $27.7 million under ESAA grants and $2.5 million under a Magnet School grant—a total of $30.2 million. This represented about 8 percent of the school district's identified desegregation costs. The combined federal, state, and local funds for desegregation activities totaled $385.9 million.

We found that the federal funds from both grant programs were used for desegregation activities that were consistent with the court order. Records for the Magnet School grant showed funds were used for program activities approved by Education. Because complete ESAA grant records were unavailable, however, we could not determine whether these funds were used for grant purposes approved by Education.

Desegregation Costs and Funding

According to information provided by the monitoring office, the school district's total desegregation costs of $385.9 million were primarily funded locally by the Cleveland School District (59 percent), with the Ohio department of education contributing about 33 percent and the federal Department of Education the remaining 8 percent (as shown in table 2.1). Federal funding, although a small percentage overall, was significant compared with state and local funds during the first 3 years of the desegregation effort.

Of the $30.2 million in federal funds, $27.7 million was from Education ESAA grants for the 5 school years 1977-78 through 1981-82 and $2.5 million was from the Magnet School grant for the 1985-86 and 1986-87 school years. In school years 1982-83, 1984-85, 1987-88, and 1988-89, no federal funding for desegregation activities was budgeted or reported. Federal funding through ESAA ended in 1982, when the Omnibus Budget Reconciliation Act of 1981 consolidated 38 federal educational programs into a single block grant to each state. Officials said federal block grants may have been used for desegregation activities, but because school districts were not required to report how the grant funds were used, we could not determine whether they in fact were.

Table 2.1: Funding Sources for Desegregation in the Cleveland School District (1978-87)

Dollars in millions

District fiscal year	Funding source			Total costs
	Federal[a]	State	Local	
1978	$0.5	$0	$1.7	**$2.2**
1979	5.1	0	5.7	**10.8**
1980	11.1	2.0	9.4	**22.5**
1981	7.1	1.9	30.0	**39.0**
1982	3.9	4.3	33.3	**41.5**
1983-85	0	91.0[b]	71.7	**162.7**
1986 (6 months)[c]	1.4	9.0	25.2	**35.6**
1987	1.1	22.0	48.5	**71.6**
Total	**$30.2**	**$130.2**	**$225.5**	**$385.9**
Percent	**7.8**	**33.7**	**58.5**	**100.0**

[a]Federal funds were assigned to the fiscal year most closely corresponding with the federal grant periods. Federal block grants awarded to the school district through the Ohio Department of Education in fiscal years 1982-89 may have been used for desegregation activities, but records indicating the amounts spent for these activities were not required or maintained.

[b]The state contributed $37 million of this amount in 1983 to make up for its limited contributions in previous years.

[c]At the end of 1985, the district's fiscal year changed from January 1 (ending Dec. 31) to July 1 (ending June 30).

Use of Federal Funds for Court-Ordered Desegregation Activities

According to available records, the Cleveland School District used $27.8 million (92 percent) of the $30.2 million in federal grant funds for activities that were consistent with the court-ordered desegregation plan. From records we examined and used to develop our estimates, we could not determine how the remaining $2.4 million was used. As shown in table 2.2, most of the $27.8 million—about $23.2 million—was used to support activities under 9 of the 14 requirements outlined in the plan. About $4.7 million was used for activities not specified in the plan; the monitoring office, however, considered these activities to be appropriate desegregation costs.

As previously discussed (see p. 11), our estimates of how the ESAA grant funds were used were formulated from a combination of expenditure and budget data. According to a monitoring office attorney and the manager of the school district's accounting division, this was the best information available; therefore, some of these data are based on planned, rather than actual, expenditures. Actual expenditure information and records were available for Magnet School grants. Budget data showed

that federal grant funds of $4.7 million were spent on some desegregation activities not specified in the 14 requirements, including the monitoring office.

We noted that no federal funds were budgeted for transportation (in accordance with prohibitions in federal law), but transportation was an allowable desegregation cost for the state and the school district.

Table 2.2: Use of Federal Funds for Desegregation by the Cleveland School District (1978-87)

Dollars in thousands

Activity[b]	School years[a] 1977-78 through 1979-80	1980-81 and 1981-82	1985-86 and 1986-87	Total
Plan requirements:				
Testing and tracking	$29	$156	[c]	**$185**
Reading	406	2,903	[c]	**3,309**
Counseling and career guidance	477	295	[c]	**772**
Magnet schools and programs/ vocational schools and programs	1,059	1,584	$2,527	**5,170**
Extracurricular activities	483	587	[c]	**1,070**
Staff development and student training in human relations	3,459	1,953	[c]	**5,412**
School community relations	1,077	1,090	[c]	**2,167**
Safety and security	2,930	1,067	[c]	**3,997**
Management and finance	1,005	83	[c]	**1,088**
Subtotal	**10,925**	**9,718**	**2,527**	**23,170**
Nonplan requirements:				
Office on school monitoring and community relations	1,163	1,265	[c]	**2,428**
Preimplementation activities	90	[c]	[c]	**90**
Nonreading instruction	2,092	59	[c]	**2,151**
Subtotal	**3,345**	**1,324**	[c]	**4,669**
Other (could not identify)	**2,389**	[c]	[c]	**2,389**
Total	**$16,659**	**$11,042**	**$2,527**	**$30,228**

[a]Data for school years 1977-82 were obtained from reports by the district office on school monitoring and community relations and the Cleveland School District budgets.

[b]The five activities for which federal funds were not used were student assignments; cooperation with universities, businesses, and cultural institutions; student rights; transportation; and staff desegregation.

[c]No federal funds were used.

Use of Federal Funds for Education-Approved Desegregation Activities

Of the estimated $30.2 million in federal funds that the school district received, we could only determine whether $2.5 million in Magnet School grant funds was used for purposes approved by the Department of Education. Its records for the ESAA grants had been destroyed, and complete school district records were not available. Our examination of Magnet School grant objectives and expenditures showed funds for these grants were used for the purposes specified by Education.

Magnet School Grant Objectives and Achievements

The approved Magnet School grant applications stated that the following activities would be carried out during the first and second years:

- develop and test thematic magnet programs in each of the 12 comprehensive high schools; for example, "Technology in the Classroom," "Academic Competition," "The Research High School," and "Global Studies";
- develop and start an elementary level magnet school featuring the best of various approaches to teaching, back-to-excellence concepts, and use of creative instructional aids;
- adapt and start six elementary level magnet schools for implementation during the 1987-88 school year;
- provide educational services to students and faculty (1) using university resources at the law and public service magnet school and professional artists at the arts magnet school and (2) enhancing students' performing skills by implementing new musical units at the arts magnet school;
- develop and test the redesigned curriculum for the technical-vocational program;
- develop and implement a comprehensive model for evaluating the magnet school program; and
- prepare reports for the Department of Education.

According to Education officials, they were aware that the school district experienced start-up problems with the Magnet School grant. Education's monitoring reports indicated that from October 1985 until February 1986, some planning and development activities took place under the grant, but no classroom activities took place because staff had not been selected and approved. Later, monitoring reports indicated that grant operations were progressing, but acknowledged problems associated with the initial implementation activities.

On completion of the grant period, the school district (in a December 29, 1987, program evaluation report) informed Education that with two

exceptions, all grant objectives were met. Reported accomplishments included establishing a computer technology center for elementary school students and developing a broadened and updated music curriculum for the arts magnet school. In addition, the purchase of new musical instruments and electronic equipment provided opportunities for supplementary educational services. The two objectives not achieved were (1) the high school thematic magnet program (pilot testing of the curriculum had not occurred at 9 of 12 schools) and (2) the redesigned curriculum for the technical-vocational program (curriculum development for new courses was incomplete).

Magnet School Grant Expenditures

The grant applications for magnet schools described the kinds of activities to be conducted and the resources, such as personnel and equipment, needed to support the activities. The accounting records for the school district showed that funds were expended for the activities cited in the grant applications, and the percentages of funds spent in the various cost categories were generally consistent with the grant application estimates. Expenditures charged against the grant, according to the school district's accounting records, are shown in table 2.3.

Table 2.3: Magnet School Grant Expenditures According to Cost Category in the Cleveland School District
(School Years 1985-86 and 1986-87)

Cost category	Amount	Percent
Equipment	$1,098,000	43.4
Salaries	877,000	34.7
Purchased services	205,000	8.1
Supplies and materials	239,000	9.5
Support services	108,000	4.3
Total	**$2,527,000**	**100.0**

Most of the equipment was purchased for the redesigned curriculum of the technical-vocational program. The grants included funds for outfitting two technical high schools with

- job exploration laboratories containing equipment for newly developed courses in agri-business, human care services, information processing, industrial technology, electronics technology, marketing, transportation, and career decisions and
- job preparation laboratories containing equipment for newly developed courses in child care, electronics, information processing, and computer-aided graphics and design.

Fourteen equipment purchases, totaling $731,000, were made for the redesigned program. This equipment was purchased for the job exploration and preparation laboratories. We obtained documentary information on the use of the equipment and visited one school to verify the information. As of September 1988, the equipment was installed and operational for 11 of the 14 purchases. The director of the technical-vocational education division told us that the equipment for the other three purchases would also be installed in school district laboratories. These three purchases consisted of 24 computers, 8 printers, and computer anti-theft devices, costing, in total, $86,000. The director said the computers and printers were placed in storage or loaned out pending building renovations scheduled for completion in January 1989.

Our review of the $877,000 in salary charges indicated that the funds were used to pay salaries of personnel working in the positions approved in the grant applications. Further, the salaries for these positions were charged to the grant, consistent with the approved grant applications. For example, positions that were to be filled throughout the entire school year reflected charges in the accounting records throughout the entire year. Positions that called for employees to work on activities for such short periods as 2 weeks reflected charges that varied in amount, with most charges made in a single month, as would be expected. After noting these patterns, we did no further tests of salary charges.

Our review of purchased services ($205,000) showed they were primarily ($137,000) for grant-approved services, which employees of a local university were to provide to teachers and students at the law and public service magnet school. We found, however, that the school district paid the university for these services without receiving documentation to support the actual time charges for the services performed, as specified in the agreement between the parties. This matter is discussed in more detail in chapter 3 (see pp. 32-36).

Our review of accounting records for the remaining two cost categories—(1) supplies and materials and (2) support services—was limited to identifying how the school district reported the funds were used. Although we did no tests to compare accounting records with source documents, records indicated that the charges for supplies and materials of $239,000 were primarily for instructional supplies, teaching aids, and textbooks. The $108,000 charged against support services was primarily for program evaluation, payroll processing, accounting, and purchasing.

These kinds of supplies, materials, and services were consistent with those approved in the grant.

Conclusions

The limited information we obtained from the school district and the independent monitoring office indicated that the district generally used the $30.2 million for purposes consistent with the desegregation court order. We were unable to determine whether the ESAA grant funds were used as specified in the federal grant agreements because records were unavailable, but Magnet School grant funds were used as specified.

Noncompliance With Federal Regulations for Grant Administration

Although grant funds for magnet schools were used for purposes approved in grant agreements, we found that the Cleveland School District did not comply with Education's regulations for grant administration. Requirements in the regulations, as well as the grant agreements, cover such matters as submitting financial and program reports, maintaining adequate accounting records, managing cash advances, procuring goods and services, and adhering to restrictions on obligating and spending grant funds. The school district certified in its grant applications that it would comply with all such requirements. We found, however, that the school district

- requested, received, and retained excessive advances of federal grant funds because it neglected to report cash on hand and cash needs data accurately;
- obligated and spent first-year grant funds, totaling $1.4 million, in the second grant year without obtaining required Department of Education authorization;
- did not submit required financial status reports to close out its grant in a timely manner; and
- inadequately documented the reasons for selecting high or sole bidders when purchasing equipment and paid for contract services without receiving the required documentation that the services had been performed.

At the close of the grant ending September 30, 1987, the school district retained $197,000 of unneeded cash from advances, which should have been returned to the U.S. Treasury. The school district still had these funds in January 1989. In addition, to support other Department of Education grant programs during fiscal year 1986, the school district used more than $1.5 million of carryover ESAA grant funds remaining in its accounts from school years 1979-80 and 1981-82. Of the total amount, the school district transferred $825,000 to the Magnet School grant account. The district did not inform Education officials of its actions. The use of funds from earlier years and other grant programs is prohibited, unless written approval for such transfers is given by Education officials. In addition, according to Education records, no funding adjustments were made to subsequent grant awards; therefore, the school district received $1.5 million more than it should have.

The deficiencies we found in the school district went undetected because Education officials did not carry out their responsibilities as prescribed by federal regulations and the Office of Management and Budget (OMB) circulars.

Cash Advances Exceeded Requirements

Our analysis showed that the school district (1) received and inappropriately retained $1,553,000 in federal funds awarded through several ESAA grants and (2) received and retained excessive cash balances under magnet school grants. Although the district's financial reports to Education included evidence that the school district's cash advances exceeded needs, Education took no action to have the funds returned. Furthermore, the interest earned by the school district on federal funds was not remitted to Education, as required by federal regulations.

After Education awards a grant, grantees may obtain federal funds to carry out approved grant activities in one of two ways—an advance of funds before actual outlays of cash are made or reimbursement of actual expenditures. According to Education's regulations, a grantee qualifies for receiving advances if it has

- procedures that minimize the time between transfer of funds from the U.S. Treasury and disbursement by the grantee and
- a financial management system that meets Education standards for fund control and accountability.

According to Education Finance Office officials, the school district met the above criteria and received federal funds through cash advances. Federal cash advance requests are to be (1) limited by the grantee to the minimum amounts needed and (2) timed to coincide with immediate cash needs. Under this policy, grantees are to submit monthly requests for advances; that is, advances should be limited to meeting anticipated expenditures for 1 month. This policy does not permit less frequent requests because they would result in advances covering excessive periods of time. According to federal regulations, interest or other investment income earned on advances of grant funds generally must be remitted to Education.

According to federal regulations, Education is to monitor advances by requiring grantees to submit a federal cash transaction report every quarter. These reports enable Education to determine the amount of cash the grantee has on hand; Education subtracts disbursements during the quarter from cash available (the sum of cash on hand from Education at the beginning of the quarter and cash receipts for ongoing Education grants during the quarter). Department officials told us they rely on the grant recipient to request only the cash needed for expenditures and to correctly report cash on hand.

Unauthorized Use of ESAA Grant Funds for Magnet School Grant

Education regulations specify that grantees are to refund unused cash at the end of a grant. The district, however, retained $1,553,000 from the ESAA grant funds received for the 1979-80 and 1981-82 school years. It used $825,000 to pay for the first 14 months' expenses incurred under the Magnet School grant (from Oct. 1985 through Nov. 1986). Accounting records for the school district showed the $825,000 was transferred from the ESAA accounts to the Magnet School account. There was no indication that Education had been told about these funds or had authorized the funds' transfer. The school district used the balance of the ESAA grant funds ($728,000) for other Education grants. These funds should have been returned to Education and the earned interest remitted, according to federal regulations.

Records are no longer available, the manager of the school district's accounting division said, to explain the circumstances under which the school district retained these funds. Further, although federal regulations require grantees to report and remit any interest earned on cash from a grant, the manager acknowledged that the school district had not done so. According to the manager, the school district should not be held responsible for the interest because nonfederal funds were frequently used to temporarily cover costs when federal funds were not received promptly.

According to Education officials, they were not aware that the district had funds remaining from the ESAA grants. Further, the district did not inform them that part of these carryover funds would be used for magnet schools. Because so much time has passed since the ESAA program ended, the officials said, no records were available to show whether the ESAA grants were ever closed out by Education.[1] They said, however, that the total $1,553,000 in funds should have been returned to Education and not used for any other activities without authorization. According to Education records, no funding adjustments were made to subsequent grant awards on the bases of these funds.

The Cleveland School District, however, stated that it applied these funds, including the $825,000 for the Magnet School grant, to other Education grants. As a result, the school district said, it received $825,000 less in cash advances than it should have. Education officials told us they are negotiating with school district officials on this issue.

[1]At a minimum, these records would include information on the submission of required financial reports and program evaluations by the grantee at the end of the grant, the refund or other disposition of unobligated cash balances, and the upward or downward adjustment of the federal share of grant costs.

Magnet School Grant Obligation Requirements Not Followed

Education approved Cleveland's Magnet School grant activities for a 2-year period, from October 1, 1985 to September 30, 1987. The first-year grant was for $1.4 million and the second-year grant, for $1.3 million. Under the Department's requirements, however, funding is approved for only 1 year and funds must be obligated within that year.[2] If not so obligated, the funds may be carried over into the succeeding year, provided that Education gives its written approval.

During the first-year grant, Cleveland did not request or obligate any funds from Education. During the second-year grant, the school district obligated and spent the $1.4 million from the first-year grant without prior written approval from the Education grants officer. Therefore, Cleveland obligated grant funds in violation of Department requirements.

More Funds Requested Than Needed

The school district requested more federal funds than needed throughout the 2-year magnet school grant. At the end of the grant period, it had an excess of $197,000 that should have been returned to the federal government. The interest earned on this excess cash had also not been reported or remitted as required.

The school district did not request cash advances under the magnet school grant from October 1985 to February 1987. The first such advance amounted to $1,085,000 and was received in February 1987—enough to fund expenditures through June 1987. By that time, as indicated in table 3.1, the district had spent the $825,000 carryover of ESAA grant funds and $175,000 of nonfederal funds. The second advance, received in July 1987, was for $722,000 and covered all grant expenditures made through December 31, 1987. The third advance—$91,000—was received in January 1988, even though $106,000 remained from the previous advance. This advance increased the ending cash balance on the grant to $197,000, which the district still retained as of January 1989. This grant should have been closed out promptly, with the funds and earned interest returned to Education.

Further, the school district did not accurately report its cash needs to Education. The manager of the accounting division told us that the amounts requested were based on available information on expenditures

[2]Obligations are the amounts of orders placed, contracts and grants awarded, services received, and similar transactions during a given period that will require payment during the same or a future period.

and obligations at the time; the amounts were, therefore, the district's best estimates. We found, however, that information available when the district submitted the three requests indicated that less cash was needed. For example, the February 1987 and July 1987 advances were both based on estimated expenditures for 3-month periods, rather than for 1 month as prescribed by federal regulations. In addition, when requesting the $91,000 advance in January 1988, the district reported to Education that it had $9,000 on hand as of September 30, 1987. But the balance on that date was actually $353,000. Further, according to Cleveland School District documents, no grant expenditures were made after December 1987.

Table 3.1: Cash Advances and Expenditures for Magnet School Grants in the Cleveland School District (Feb. 1987-Jan. 1988)

Dollars in thousands

Month	Beginning balance	Cash advance receipt	Funds available	Expenditures	Ending balance	Ending balance exceeded next month's expenditures
Feb. '87	−$175	$1,085	$910	$415	$495	Yes
Mar. '87	495	[a]	495	138	357	Yes
Apr. '87	357	[a]	357	109	248	Yes
May '87	248	[a]	248	60	188	Yes
Jun. '87	188	[a]	188	116	72	No
July '87	72	722	794	127	667	Yes
Aug. '87	667	[a]	667	135	532	Yes
Sep. '87	532	[a]	532	179	353	Yes
Oct. '87	353	[a]	353	145	208	Yes
Nov. '87	208	[a]	208	45	163	Yes
Dec. '87	163	[a]	163	57	106	Yes
Jan. '88	106	91	197	[b]	197	[c]

[a]No cash advances received.

[b]No expenditures made.

[c]Does not apply because no expenditures were reported after December 1987.

In the absence of other information, Education Finance Office officials said, they advance funds to grantees like the Cleveland School District if the cumulative requests do not exceed the total grant funds authorized for a given period. Further, the Finance Office does not review any documents or records to determine the basis or the need for cash advances, relying completely on the grantees to request only the cash needed for the next month. Education, in commenting on our draft report, said that a reconciliation of the Cleveland account was carried out in December

1988, identifying excess cash. Education reported that as a result of the reconciliation, the Cleveland School District sent a $200,000 check for these excess funds.

Cash Management Practices Not Reviewed

Treasury regulations make federal agencies responsible for (1) reviewing the financial practices of grantees to ensure that grantees comply with federal regulations and (2) instituting remedial measures, as necessary, in the event grantees are unwilling or unable to comply with these regulations. If a grantee does not minimize the time between receiving advances and disbursing them, Treasury regulations specify that the federal agency funding the grant may terminate advance financing, require the grantee to use its own funds to finance operations, and, later, reimburse the grantee for disbursements.

Education said it was unaware that the school district had received cash advances that exceeded requirements. Education should have been aware of this situation, however, because it had evidence about inadequacies in the district's cash management practices from the Magnet School grant. For example:

- The entire first school year (1985-86) and 3 months of the second elapsed before the district requested a cash advance from Education. This should have raised questions at Education as to how the district was funding grant activities.
- The district's first federal cash transaction report was submitted for the quarter ended September 30, 1986, the end of the first grant award period; the report showed cash on hand of $241,000. This should have raised questions about where the funds came from because the district had neither requested nor received cash advances from Education for the grant.
- The district did not receive a cash advance for the months of March through June 1987, raising questions about whether the February 1987 cash advance was to cover more than 1 month's expenditures. In addition, the July 1987 cash advance was sufficient to meet grant expenses through January 1988.

Under its financial management system, Education officials said, the agency compiles data and tracks cash advances on the basis of the total amount of federal grant funds, not individual amounts, available to a grantee from all grants during a given period. Cash advances, made against a grantee's individual identification number, reduce the total

amount available during a given period. The system is designed, however, to prevent cash advances from exceeding the total authorized amount available to the school district from all Education funds available. The Finance Office prepares a quarterly statement for each grantee, the officials said, showing the total amounts authorized and disbursed for each individual grant. The grantee is expected to reconcile Education's disbursements with grantee records and return the adjusted statement to the Finance Office. Officials said they rely on grantees to make appropriate adjustments to the quarterly reports; audits and on-site visits are needed to find errors.

In comments on how it carried out its oversight responsibilities, the Department of Education said that (1) its payment management system depends on correctly reported expenditures by grantees and (2) this system cannot prevent grantees from submitting inaccurate information. Education explained that these problems and others are generally discovered through Single Audit Act audits,[1] special OIG audits, and other special reviews.

We agree that the system cannot prevent grantees from submitting inaccurate data on financial and program matters and that audits and reviews help to discover such problems. Our review, however, showed that Education carried out minimal monitoring of the Cleveland School District's program and financial activities relating to its Magnet School grant. Education did not follow up on available evidence, such as that discussed on p. 26, that should have raised questions about the district's cash management practices. Unless Education places more emphasis on effective monitoring, similar problems could continue to occur and may remain undetected because Education cannot be fully assured that audits and reviews will discover all irregularities.

Financial Status Reports Not Filed

When the Magnet School grant was awarded, Education regulations required that grantees submit a financial status report (form 269) annually or within 90 days of the expiration of a grant or both. This report shows the total funds authorized, obligations incurred, and expenditures made under an individual grant. In this report, the grantee also certifies

[1]The Single Audit Act of 1984 (P.L. 98-502) requires state or local governments (including school districts) receiving $100,000 or more a year in federal financial assistance to have annual audits conducted by an independent auditor, including public accounting firms, in accordance with generally accepted government auditing standards. In Education, OIG is responsible for ensuring that audits are made and reports received in a timely manner and in accordance with prescribed federal standards. OIG is also responsible for overseeing (1) the distribution of audit reports to responsible Education components and (2) the resolution of audit findings.

the amounts claimed for indirect costs, the nonfederal matching share contributed to the grant project, and any income earned as a result of the grant. This report is important because it is used in closing grants and determining whether grantees should return federal funds. Education officials review the report to determine the extent to which a grantee used federal funds to pay for direct costs incurred in accomplishing grant objectives. The school district did not submit its status report to Education at the end of the first grant year, as required. If this report, with the correct financial information, had been submitted, it would have shown that the district had an unobligated balance of federal funds. In addition, the required financial status report, due at the end of the second grant year, was not submitted promptly. According to district officials, reports covering both grant awards were submitted in July 1988. These reports indicated that the unobligated balance at the end of the grant was $224,000. As of January 1989, however, Education officials said they had not received these reports. After we called this matter to their attention, Education officials wrote a letter in February 1989 to the Cleveland School District requesting that excess funds be returned.

In April 1987, grants management officials at Education issued a bulletin to establish new guidance and procedures for the financial status report. The bulletin explained that requirements for the grant recipient's filing of this report were waived except for grant awards with program income, restricted indirect cost rates, or nonfederal cost-sharing and matching requirements. According to these officials, the waiver affected about 60 percent of the grant recipients; however, Education never notified the grantees of this change. The grants management officials said that instead of the financial status report data, they planned to use data collected by Education's Finance Office to determine whether the grantees had excess federal funds that should be returned.

Audit Reports Discussed Findings Similar to GAO's

We reviewed a January 1987 audit report prepared by a public accounting firm under the Single Audit Act. The report covered school district activities funded with federal financial assistance—primarily from Education. This audit covered the period January 1, 1985, through June 30, 1986, and included tests of various transactions for several Department of Education categorical grant programs. The audit report did not include the Magnet School program grants that we reviewed, but it did address the ESAA grant funds.

The audit report included discussions of several of the same problems that we noted during our review. It also included a number of recommendations to the school district to rectify the problems noted, bring the school district into compliance with federal regulations, or both.

The problems in the public accounting firm's audit report that were similar to our findings on cash management of federal grant funds included the following:

- Education grant funds were improperly transferred from one funding year to another.
- Financial status reports for individual grants were not submitted promptly or not submitted at all. As a result, federal grants were not closed out.
- Excess cash advances of federal funds were received and retained for long periods.
- Interest income earned on federal cash advances was not reported or remitted to Education.
- Inaccurate expenditure data were reported to federal agencies, and detailed accounting records did not support expenditure data reported.

School district officials stated that corrective action had been taken or would be taken on all the issues in the audit report, except the one dealing with interest income due to the federal government. On this issue, school district officials disagreed, stating that ". . . many of the federal funds operate in a deficit position which are subsidized by the [school district's] general fund."

This January 1987 audit report was not made available to Education officials in Washington headquarters until February 1989. Meanwhile, another audit report has been prepared by a different public accounting firm; it concerns federal financial assistance to the school district during its fiscal year ending June 30, 1987. According to the OIG representative, this audit report, dated December 31, 1987, and accepted by the Ohio state auditor in April 1988, was also released to Education program officials in February 1989. This second audit report included findings related to Education grants on the submission of required financial reports and program evaluations, interest income earned on federal funds, and indirect cost allocations.

Internal Controls Program Identified Grants Management Weaknesses

We reviewed the fiscal year 1987 and 1988 reports on Education's Internal Controls Program, which are required by FMFIA. The 1987 report included discussions of four internal control weaknesses concerning grants management. Two of these dealt specifically with issues that we reviewed: (1) monitoring grant compliance and (2) grant closeouts.

Monitoring Grant Compliance

The report stated that monitoring grant compliance had been a pervasive weakness throughout Education, and directives on grant monitoring needed to be completed and implemented. According to the report, in August 1985, the Under Secretary of Education issued a directive to improve the quality of monitoring of categorical grants, establishing minimum standards that all offices were expected to follow. The report went on to say that the policies and procedures in this directive had significantly strengthened and improved the Department's grant-monitoring activities. The report also indicated that this Department-wide weakness had been corrected and, therefore, it was deleted from the list of internal control weaknesses.

The Office of Management Improvement Services is responsible for ensuring that internal control weaknesses in Education are identified and corrected. According to representatives of this office, no documentation showed that action other than issuing the directive had been taken by Education concerning this Department-wide weakness. That is, no follow-up had been initiated and no test had been done to assure that the provisions of this directive had been implemented and monitoring activities had, in fact, improved throughout Education.

Grant Closeouts

The report stated that (1) grant closeouts had been a pervasive weakness throughout Education and (2) a process was needed to ensure that all grants are closed out promptly after expiration. Other documentation disclosed that during fiscal year 1987, a backlog of about 14,000 expired grants were awaiting closeout. Recommendations for a process for closing out expired grants had been developed, the fiscal year 1987 report said, and the implementation of these recommendations resulted in eliminating the backlog.

In February 1989, officials of Grants and Contracts Services (the office in Education responsible for grant and contract administration) told us that the 14,000 expired grants had not been closed out. Rather, Education officials had decided to remove the official grant folders from Education and transfer them to the Federal Records Center. But Education officials had not taken the steps prescribed by federal regulations (1) to ensure that required financial reports and program evaluations had

been submitted and (2) to determine whether grant objectives were achieved and federal funds should be returned. These officials said that, in effect, waivers exempting the 14,000 grants from being closed out had been approved, but, to their knowledge, this waiver decision was not documented.

According to the fiscal year 1987 report, grant closeout requirements had been developed and integrated into the design of a new grants and contracts management system; installation of the closeout function of the new system was scheduled for December 31, 1987. This internal control weakness concerning grant closeouts was not mentioned in the fiscal year 1988 report. Officials in the Grants and Contracts Service told us, in February 1989, that the new system was not yet fully implemented, but they hoped that it would be by December 1989.

In commenting on the closeout of the 14,000 grant files in 1987, Education defended its actions by stating that since the formation of the Department, closeouts had assumed a lower priority than making timely awards to achieve national objectives. Education also explained that resources were allocated accordingly and, because of staffing constraints, a large backlog of files to be closed out resulted. Education added that when it implemented automation and streamlined the process used to handle an increasing volume of grant awards, it also implemented improvements to its payment management system. Education said the closeout of the 14,000 files, which included the cursory review of these files and the issuance of waivers for missing reports, was tied to these changes. This closeout effort, according to Education, allowed the Department to conduct a massive deobligation of unspent grant funds in 1987, to the benefit of the federal government.

We recognize the large volume of grant review and award activity that Education faces annually and that various grants management and payment changes have been implemented to cope with the workload. Education officials, however, who work in offices responsible for programs, grants management, and funding should coordinate the implementation of these changes. They should ensure that the new systems and policies, when fully implemented, will lead to more effective administration and monitoring of the Department's grant activities and more timely and efficient actions in closing out grants, as required by federal regulations.

Procurement Requirements Were Not Followed

The school district did not comply with some Education procurement regulations. Purchases of over $10,000 were not fully documented, and receipt of contracted services was not properly verified. Education was unaware of these weaknesses in the school district's procurement system and practices because Education did not review the system before the grant award.

Education Did Not Review the District's Procurement System

Education officials said they generally do not assist in establishing or reviewing a grantee's procurement system, although applicable OMB circulars encourage such actions. OMB circular A-102, attachment O, in effect at the time of the Magnet School grant, permitted a federal grant recipient to use its own procurement system provided it was consistent with Education's regulations. This circular requires free and open competition and documented justification for purchases in excess of $10,000.

OMB circular A-102 included requirements for assistance to state and local governments and encouraged federal agencies to review a grantee's procurement system if a (1) continuing relationship with the grantee is anticipated or (2) substantial amount of the federal assistance is to be used for procurement.[1] This review is to (1) determine whether a grantee's procurement system meets federal standards and (2) give an agency an opportunity to provide technical assistance to a grantee if its procurement system does not fully comply with the federal requirements. To the maximum extent feasible, reviewers are to rely on evaluations and analyses done by agencies or organizations independent of the grantee's procurement system. We found no evidence that Education had reviewed the school district's procurement system and practices, even though the district's procurement expenditures appeared to meet the criteria for federal review.

Procurement Records Did Not Include Required Explanations

Our review of procurement records showed that the school district did not comply with Education regulations specifying that procurement records for purchases in excess of $10,000 are to include the

[1]Attachment O of this OMB circular established standards for the procurement of supplies, equipment, and services for federal assistance programs. These standards are designed to ensure that supplies, equipment, and services are obtained efficiently, economically, and in compliance with provisions of applicable federal laws and executive orders. On March 3, 1988, this circular was revised.

- basis for contractor selection,
- justification for lack of competition when competitive bids or offers are not obtained, and
- basis for award cost or price.

For review, we selected procurement records for six equipment purchases of over $10,000 each, which totaled $671,985—61 percent of all equipment purchases under the Magnet School grant. We were unable to review three of the purchases because the district could not locate such key documents as the proposals submitted by competing bidders. The procurement records for the other three purchases were more complete with requisitions, bidders' proposals, bid summaries, and purchase orders. The procurement records for these three purchases, however, did not include certain information required by Education regulations.

The first equipment purchase, totaling $300,288, was for hardware and software to equip a computer-aided design laboratory. The district issued a request for proposal with 23 individual line items to bidders, but it did not require or direct bidders to bid on all line items. The request stated that the district reserved the right to make awards by line item or to the lowest total bidder. The district awarded the purchase to a bidder who submitted prices on all 23 line items. Other bidders, however, with proposals bidding on some, but not all, of the line items, submitted prices for individual line items that were lower than those proposed by the bidder receiving the purchase award. For example, the bidder that won the award made a bid of $112,890 for 26 personal computers. The bids from three other bidders were lower—$93,626, $104,780, and $104,000. The procurement records for this purchase did not explain the basis for the bidder selection.

The second equipment purchase, totaling $56,794, was for hardware and software to equip a computer-aided graphics laboratory. The request for proposal stated that bidders could quote prices on the brand specified or an equal brand, stating brand and specifications. Two bidders submitted prices of $39,990 and $56,794, with the award going to the highest bidder. The bidder that won the award proposed using the specified brand; the other bidder proposed a brand it claimed was more powerful than the specified brand. The records for this purchase did not explain the basis for the bidder selection.

The third equipment purchase, totaling $98,352, was for nine electronic work stations to equip an electronic job preparation laboratory. The request for proposal included a requirement that the equipment must be

compatible with the equipment at another school. The bidder that won the award was the only bidder. Three other firms returned the requests with no bids. The records for this equipment purchase did not include an explanation of the basis of the award price.

Contracted Services Not Documented by Actual Expense Records

The school district paid for contract services without reviewing the contractor's actual expenditures, even though both parties had agreed actual expenditures would be documented and form the basis for payment. The district's action was contrary to Education regulations that require grantees to ensure that each contractor conforms to contract terms, conditions, and specifications.

The school district entered into an agreement with a local university to provide services for the law and public service magnet school. The services included

- providing students access to libraries, computer facilities, faculty and staff expertise, assemblies, special events, and joint program classes; and
- working with teachers to review, update, or create new curriculum units for all courses.

Under this agreement, the district paid the university $90,000 for services during the first grant year and $46,844 during the second. For each year, the school district and the university agreed on the estimated costs to be incurred under the agreement. Those for the first year are shown in table 3.2; a similar agreement was made for the second year.

The agreement for both years stated that the school district would pay the university's expenses each month (up to $90,000 for the first year and $46,844 for the second year) on receipt of an invoice setting forth the activities the contractor carried out under the agreement and the costs. The district paid the university for the activities on the basis of invoices that showed no information on actual expenses incurred. Instead, the invoices were based on a monthly prorating of the total agreement amount; for example, the July 1986 billing was for $7,500, one-twelfth of the maximum agreement amount of $90,000.

Education officials said that a copy of Education's regulations—including procurement standards—is sent to each grantee. The officials expect each grantee to establish and follow a sound, responsible procurement system; they do not generally review grantees' procurement systems

before grant fund awards or procurement activities during grant projects. In addition, they expect grantees to follow federal procurement regulations and notify Education's procurement officials if questions or problems arise.

Table 3.2: Estimated Costs Under University Agreement (Oct. 1, 1985-Sept. 30, 1986)

Employee	Percent of salary charged to contract	Estimated salary costs
A	35	$15,875
B	18	7,938
C	33	7,937
D	86	18,000
E	86	18,000
Subtotal		**67,750**
Fringe benefits[a]		15,583
Subtotal		**83,333**
Indirect costs[b]		6,667
Total		**$90,000**

[a]Fringe benefits were 23 percent of $67,750.

[b]Indirect costs were 8 percent of $83,333.

Audit Reports Disclosed Procurement Weaknesses

The school district's internal audit reports indicated that its procurement system needed improvement. Although the reports did not include reviews of the Magnet School grant, they did include some of the same procurement weaknesses that we found. For example, a June 1985 internal audit report stated that several studies of purchasing carried out by both outside consultants and school district management disclosed weaknesses, but resulted in little follow-up action. Moreover, a January 1987 follow-up report stated that actions taken since the June 1985 report often did not comply with or respond to the recommendations.

The most recent internal audit report on purchasing, issued in May 1988, covered purchases that occurred during the second year of the Magnet School grant. This report included findings similar to ours, for example:

- Purchases of materials or services for federally funded programs or activities appeared to be technically not in compliance with federal procurement standards on purchases of $10,000 or more.
- Sometimes the school district did not consider a contract proposal because it was termed "incomplete." It appeared the district, however,

categorized a proposal as incomplete when a bidder chose not to bid on all items. Often a bidder with an incomplete proposal had the lowest bid on the items quoted, but was not awarded any of the purchases.

- Specifications in the district requests for proposals were so restrictive that they tended to eliminate or reduce competitive bidding.

The May 1988 report discussed several recommendations, including the following: the school district purchasing division should acquire copies of the federal procurement regulations and distribute them to all purchasing personnel working on federally funded programs. These regulations were not obtained by the school district until we provided them during our review in September 1988.

Conclusions

Education's lack of oversight and the Cleveland School District's noncompliance with federal grant regulations contributed to the cash management and procurement problems we observed during our review. The district accumulated excessive federal cash balances and retained them for long periods, did not submit financial reports, and used a procurement system that did not satisfy documentation standards promulgated by Education.

The school district used $1,553,000 of carryover ESAA funds for other Education grant programs without requesting approval from Education. These funds should have been returned to Education when authorization for ESAA expired in 1982. Among other uses, the district transferred $825,000 of these funds to its Magnet School program. This in turn contributed to the accumulation of excess cash during the 2-year program.

Federal regulations provide that cash advances be requested by grant recipients at regular intervals only to meet current needs. The school district was permitted to receive large cash advances, however, even though funds were not needed to pay immediate bills. Excessive cash advances cost the federal government interest; in addition, the school district earned interest on Education's cash advances that was not reported and returned, as required.

The district did not follow standard grant conditions concerning the obligation and expenditure of Magnet School funds awarded for school years 1985-86 and 1986-87, in that it obligated the $1.4 million authorized for the first grant year during the second grant year. If correct financial status reports had been submitted as required and effective monitoring had taken place, Education officials could have known about

the improper obligation and the resultant violations might have been detected earlier.

In our limited review of the district's procurement system and practices, we noted that Education procurement regulations were not satisfied in that (1) the official contract records did not contain all required documents, for example, the basis for contractor selection and award price; (2) written justification explaining why low bidders were not awarded competitive contracts was not provided; and (3) expense records to support contract costs were not maintained.

During the 1980s, the school district received from Education categorical grants totaling millions of dollars annually. From discussions with district officials and documents obtained from them, we concluded that district policies and practices discussed in this report applied to other 1978-88 Education grants received by the Cleveland School District. Therefore, similar weaknesses and shortcomings probably would be found in these other grant programs.

Finally, our review indicates that there are systemic problems in the way Education manages its grant programs. The fiscal year 1987 report on the Internal Controls Program in Education (1) identified monitoring grant compliance and grant closeouts as weaknesses and (2) said that corrective actions had been taken. Education, however, prematurely deleted these issues from the weaknesses list; based on what we learned during this review, monitoring grant compliance and grant closeouts are still weaknesses in Education.

Recommendations

We recommend that the Secretary of Education direct the Cleveland School District to

- return the $1,553,000 of ESAA funds that remained in its accounts when the authorization for ESAA expired in 1982 and
- review its procurement system to assure compliance with federal procurement regulations.

We also recommend that the Secretary of Education work with school district officials to determine the amounts of interest earned on excessive cash balances from federal grant programs over the years, which should be returned to Education.

To determine whether Education's grant management weaknesses seen in Cleveland's Magnet School program grants are prevalent in other grant programs and other school districts, we recommend that OIG review Education's grant administration policies and practices, especially relating to cash management and grant closeouts.

Agency Comments

The Department of Education in its comments did not disagree that the Cleveland School District had received cash advances of $1,553,000 under ESAA that had not been expended for ESAA activities. Nor did it deny that this amount had been transferred, without proper authorization from Education officials, to other Education grant accounts. Education, however, stated that the Secretary is barred from recovering this $1,553,00 by 20 U.S.C. 1234a (k) because the violation—not returning the unspent ESAA funds to Education—occurred more than 5 years ago.

Education is incorrect. The statute it refers to, 20 U.S.C. 1234a (k), bars the Secretary from recovering funds under the following circumstances: if the funds have been "expended in a manner not authorized by law" (underline ours) more than 5 years before the recipient received written notice of a preliminary Education decision that the recipient is liable for such funds. Thus, the critical event is not the district's failure to return the cash, as Education contends. Rather, it is the expenditure of those funds. We, therefore, believe that our recommendation is valid because the $1,553,000 in question, although incorrectly retained by Cleveland in 1980 and 1982, was not expended until fiscal years 1986 and 1987.

The Cleveland School District, in its comments on this recommendation, acknowledged that the $1,553,000 remaining from ESAA had been transferred to three other grant program accounts. School district officials argued, however, that one of these transfers was proper because the school district had obtained approval from the Ohio department of education. District officials also stated, however, that authorization had not been sought or obtained from Department of Education officials, as required. In addition, district officials said, the other two transfers of funds were for properly approved grants and subsequent grant amounts were reduced to recognize the transfers. Our review of Education records, however, found that Education had not made such subsequent reductions in grant awards.

The Department of Education agreed that the Cleveland School District should review its procurement system to ensure compliance with federal

procurement regulations. The procurement weaknesses we had identified, said Education officials, will be considered before awarding future grants to the district. Education also agreed with our recommendation that interest earned by the Cleveland School District on cash advances for Education grant programs should be returned to the Department. Education agreed to explore the possibility of recovering these funds from the district.

Concerning our recommendation that OIG review the Department's policies and practices for grants, especially relating to cash management and closing out grants, Education stated that such actions have already been planned. It said that OIG's audit work plan for fiscal years 1989 and 1990 included an audit of Education's closeout procedures for grants and contracts. In addition, Education stated that OIG plans to conduct a survey to follow up on the deficiencies we identified concerning the Department's administration of and monitoring activities for the Magnet Schools Assistance Program.

In addition to responding to our recommendations, Education commented that additional actions are planned to correct other recognized grants management weaknesses. These include (1) plans within the Office of Elementary and Secondary Education for on-site monitoring of over half of the new fiscal year 1989 Magnet School grants; (2) the issuance of new Department directives and procedures; (3) automation of grants' monitoring systems; (4) revamping Education's payment systems; and (5) plans to provide more comprehensive close-out procedures under which grant funds will be automatically deobligated at the end date of each grant. Education stated that the automated closing feature is scheduled to be implemented during its September 30, 1989, reporting cycle.

Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF THE ASSISTANT SECRETARY
FOR ELEMENTARY AND SECONDARY EDUCATION

JAN 14 1989

Mr. Lawrence H. Thompson
Assistant Comptroller General
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Thompson:

The Secretary has asked that I respond to your request for our comments on your draft report, "Desegregation Activities: Administration of Education Grant Funds at the Cleveland School District" (GAO/HRD-89-83).

The draft report has been reviewed by various offices of the Department of Education (ED) and this letter reflects our collective responses. I will begin by responding to each of the recommendations you have provided on page 56 of your draft report. Following these responses, I will share with you some additional comments regarding material contained in your draft report.

Now on pp. 37-38

1. Return of $1,553,000 of Emergency School Aid Act Funds

You recommended that the Secretary direct the Cleveland School District to return $1,553,000 of Emergency School Aid Act (ESAA) funds that remained in its accounts when the authorization for ESAA expired in 1982. The Secretary is barred from recovering this $1,553,000 of ESAA money because the violation -- that is, not returning the ESAA funds -- occurred more than five years ago (20 U.S.C. 1234a(k)). This should be noted in the report.

2. Review of the Cleveland School District's Procurement System

You recommended that the Secretary direct the Cleveland School District to review its procurement system to assure compliance with federal procurement regulations. We concur in your recommendation that Cleveland review its procurement system. In addition, Education Department General Administrative Regulations permit the Secretary to consider "any other information relevant to a criterion, priority, or other requirement that applies to the selection of applications for new grants, including information concerning the applicant's use of funds under a previous award under the same Federal program." (See, 34 C.F.R. 75.217(d)(3).) The weaknesses GAO has identified will be considered before awarding future grants to the Cleveland School District.

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You also cite ED for not conducting reviews of grantees' procurement systems prior to making awards. In accepting a grant award, a grantee agrees to adhere to ED's procurement regulations (34 C.F.R. Part 74, Subpart P - applicable during the audited period) and is responsible for conducting appropriate reviews of its procurement system to maintain compliance with ED's procurement regulations. Although Office of Management and Budget (OMB) Circular A-102 encourages federal agencies to conduct pre-award reviews of such systems, the Circular does not require such reviews. Generally, ED does not conduct pre-award reviews because it makes approximately 4,000 new awards annually and does not have the resources necessary for such reviews. Therefore, we must rely on audits such as this one to identify weaknesses in a grantee's procurement system.

3. Interest Earned by Cleveland

You recommended that the Secretary work with Cleveland School District officials to determine the amounts of interest earned over the years on excessive cash balances from federal grant programs, that Cleveland should return to ED. In this context, you have indicated that interest earned by the school district on federal funds is required to be remitted by federal regulations. We concur with this recommendation and will explore the possibility of recovering these amounts.

4. Review of Grants Administration Policies and Practices by the ED Office of the Inspector General

You have recommended that the Office of the Inspector General (OIG) in ED review ED's grants administration policies and practices, especially those related to cash management and grant closeout, to determine whether ED's grants management weaknesses concerning Cleveland's magnet schools program grants are prevalent in other grant programs and in other school districts. An audit of ED's closeout procedures for grants and contracts is included in the audit workplan of the OIG for fiscal years 1989 and 1990. The work is scheduled to begin in June of 1989 and will include determining whether controls are adequate to assure the receipt of final products, the recovery of government-owned grantee/contractor held property, and the prevention of unauthorized cost overruns. The audit will also evaluate the timeliness of closeout procedures to preclude unauthorized use of unexpended funds. In addition, the OIG is planning to conduct survey work to follow up on the deficiencies identified in monitoring and administration of the Magnet Schools Assistance Program.

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5. Other Comments

The report indicates that Cleveland retained $197,000 of FY 1987 Magnet Schools funds that, under ED administrative regulations, should have been returned to ED. This finding has been resolved. A reconciliation of the Cleveland account was performed in December 1988, which identified excess cash. A letter was forwarded to Cleveland on January 11, 1989, advising the school district of their cash position with ED and that they should review their records for any discrepancies with our balances. A response was received in February 1989 from Cleveland which required reinstatement of a grant and revised expenditures. In addition, a check for $200,000 was received as a result of the reconciliation. The audit report should note that Cleveland has returned the excess funds to ED.

The report also cites a variety of instances where allegedly ED did not properly oversee Cleveland's use of ED funds. For example, the report finds that if Cleveland had submitted financial reports on time and if those reports had shown correct financial information, it would have shown that the district had excess funds. In fact, these reports were neither accurate nor timely. The ED Payment Management System (ED/PMS), which meets OMB requirements for a grants payment system, depends on correctly reported expenditures by grantees. Failure to submit accurate information on the part of grantees cannot be prevented by ED/PMS. Those problems, as well as others, are generally discovered through Single Audit Act audits, special OIG audits, and other special reviews. In addition, as explained above, ED's financial records on Cleveland are now current.

The report makes mention of ED's Internal Controls program under the Federal Manager's Financial Integrity Act for 1987 and 1988 which includes discussion of four internal weaknesses concerning grants management. In terms of grant monitoring, GAO recognizes the changes in internal directives which have been made and suggests that more follow-up be pursued. ED has recognized these weaknesses and taken several corrective actions, including plans within the Office of Elementary and Secondary Education for the on-site monitoring of over half of the new Magnet Schools grants made in FY 1989; new Departmental directives and procedures; automation of grants monitoring systems; overhaul of payment systems; and plans to provide more comprehensive close-out procedures which will automatically deobligate funds on grants when the end date of the grant has been reached. This feature will assure that funding does not remain available to grantees past the end date of a grant. Automated closing is scheduled for the September 30, 1989 reporting cycle. These plans and improvements should be noted in the report.

Page 4 - Mr. Lawrence H. Thompson

The report states that, in closing out some 14,000 grant files, ED had not taken steps to insure that required financial reports and program evaluations had been submitted, and that ED had not determined whether grant objectives were achieved and federal funds should be returned. Since the formation of ED, close-outs assumed a lower priority than making timely awards to achieve national objectives. Resources were allocated accordingly, and due to staffing constraints, a large backlog of files to be closed out resulted. ED implemented automation and streamlined the process used to handle an increasing volume of grant awards within ED. Included in these changes was the implementation of improvements in ED's payment management system. The close out of these 14,000 files, which included the cursory review of these files and the filing of waivers for missing reports, was tied to these changes. This effort allowed ED to conduct a massive de-obligation of unspent grant funds in 1987 to the benefit of the Federal government. The final report should explain the circumstances surrounding the close-out procedure and note that files were reviewed, waivers were filed, and unspent grant funds were de-obligated in 1987.

Thank you for the opportunity to comment. I and members of my staff are prepared to respond, if you or your representatives have any questions. Furthermore, the information provided in your report will assist ED in ensuring that any future grants to Cleveland are properly used.

Sincerely,

Daniel F. Bonner

Daniel F. Bonner
Acting Assistant Secretary

Comments From the Cleveland School District

"Providing Educational Opportunities for Success"

CLEVELAND PUBLIC SCHOOLS

[illegible] EAST SIXTH STREET - CLEVELAND, OHIO 44114 - TELEPHONE 574-8000

ALFRED D. TUTELA
Superintendent

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May 25, 1989

Mr. Larry Horinko, Assistant Director
Congressional Report Group
General Accounting Office
Room 6733, GAO Building
441 G Street N.W.
Washington, D.C. 20548

Dear Mr. Horinko:

Now on p. 5

We must disagree with the GAO recommendation contained on page 10 of the draft report entitled Desegregation Activities: Administration of Education Grant Funds at the Cleveland School District.

This recommendation is "...return the $1,553,000 of the ESAA funds that remained in the accounts when the authorization for ESAA expired in 1982".

We disagree with the recommendation for the following reasons:

1. In the calendar years 1978 through 1982, we received grants totalling $27.7 million. All the funds were expended "by the book" except for the handling of the $1,553,000 referred to above. This $1,553,000 was transferred as follows:

   A. $442,000 to Emergency Emigrant Education Program, an ECIA Chapter 2 Fund. The law allows this carryover and the transfer of this carryover was properly approved by the State of Ohio Department of Education. Documentation was available during the audit.

   B. $286,000 to Elementary and Secondary Bilingual Education Programs. These programs (G-008302647) were authorized for $357,400 and the transfer provided the initial funding.

C. $825,000 to the Magnet School Grant (G-008520208). This two year program was authorized for $2,755,000 and the $825,000 provided the initial funding.

If we are forced to return the $1,553,000 as recommended in the draft report, then we should be allowed to submit a request for reimbursement for items B and C.

Item A was properly approved, therefore the concern should be addressed to the Ohio Department of Education. On items B and C, the transfer provided the initial funding only for the properly approved grants and the grant amounts were reduced by this initial funding. This latter point is germane to the issue.

We have also opened up dialogue with the Federal Department of Education concerning our disagreement with the recommendation and are working towards resolvement. Accordingly, we request, as offerred in your May 11, 1989 phone conversation and reaffirmed in our phone conversation of May 19, 1989, that you strike this recommendation from the GAO final report.

Very truly yours,

Paul Yacobian
Treasurer

PY:pjr

CC: Alfred D. Tutela
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